IN THE DAVIDSON COUNTY CHANCERY COURT
AT NASHVILLE

SENTINEL TRUST COMPANY, and its Directors, Danny N. Bates, Clifton J. Bates, Howard H. Cochran, Bradley S. Lancaster, and Gary L. O'Brien, Petitioners, v. KEVIN P. LAVENDER, Commissioner of the Tennessee Department of Financial Institutions, Respondent.	)	No. 04-1934-I

RESPONSE TO PETITION FOR WRIT OF CERTIORARI AND WRIT OF SUPERSEDEAS

Respondent, Kevin P. Lavender, Commissioner of the Tennessee Department of Financial Institutions, by and through his attorney of record, the Attorney General and Reporter for the State of Tennessee, hereby submits this response to the Petition for Common Law Writ of Certiorari and Writ of Supersedeas seeking supervisory judicial review of the Commissioner's decision to take possession and to liquidate Sentinel Trust Company, pursuant to Tenn. Code Ann. § 45-2-1502.[1]

[1]On July ___, 2004, the record considered by the Commissioner in making the decision to take possession and to subsequently liquidate Sentinel was filed with this Court under seal. This record consisted of three volumes. References to the record shall be to R., volume number and page number.

I. INTRODUCTION AND FACTUAL BACKGROUND

Petitioners Danny N. Bates, Clifton T. Bates, Howard H. Cochran, Bradley S. Lancaster and Gary L. O'Brien are all either former directors, officers and/or shareholders of Sentinel Trust Company, a state-chartered trust company located in Hohenwald, Lewis County, Tennessee.[2] Respondent, Kevin P. Lavendar, is the duly appointed Commissioner of the Tennessee Department of Financial Institutions, and is charged with enforcing and administering the provisions of chapters 1 and 2 of Title 45 of the Tennessee Code Annotated.[3]

On April 28, 1999, the Tennessee General Assembly enacted Public Chapter 112, with an effective date of July 1, 1999. This act, as discussed further herein, made the operation and regulation of all state trust companies subject to the Tennessee Banking Act, codified in Chapters 1 and 2 of Title 45. In anticipation of the July 1 effective date, on June 16, 1999, the Department of Financial Institutions sent a memorandum to all known trust companies not previously under

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[2]Petitioners have filed their Petition for Writ of Certiorari in the name of Sentinel Trust Company and in their individual names. The Commissioner objects to any such petition being brought in the name of or on behalf of Sentinel. Tenn. Code Ann. § 45-2-1502(b)(2) provides that once the Commissioner has taken possession, "the ***commissioner shall be vested with the full and exclusive power of management and control***, including the power to continue or to discontinue the business, to stop or to limit the payment of its obligations, to employ any necessary assistants, to execute any instrument in the name of the bank, ***to commence, defend and conduct in its name any action or proceeding in which it may be a party*** . . .. (Emphasis added). Unless and until the Commissioner is ordered to return possession of Sentinel to Petitioners, he is vested with the "full and exclusive power of management and control" of Sentinel, including the commencing of any legal action in the name of Sentinel. *See also, First Savings & Loan Association v. First Federal Savings & Loan Association*, 531 F.Supp. 251, 255 (D. Hawaii 1981)("When a receiver is appointed for a corporation, the corporation's management loses the power to run its affairs and the receiver obtains all of the corporation's powers and assets."). Accordingly, the Commissioner submits that the Petition for Writ of Certiorari may only be brought in the name of the former officers, directors and/or shareholders of Sentinel.

[3]Tenn. Code Ann. § 45-1-104.

the Department's regulation.[4] The memorandum informed these trust companies that with the enactment of Public Chapter 112, they were now subject to the jurisdiction of the Department.

Subsequently, on December 31, 1999, the Department commenced a formal examination of Sentinel pursuant to Tenn. Code Ann. §§ 45-1-124(h) and 45-2-1602.[5] During the course of that examination, the Department determined that Sentinel had no written policies for any aspect of their Trust Administration Department. The Department further discovered that Petitioner Danny Bates, President of Sentinel, had virtually unrestricted access to all areas of the company with little if any compensating controls, and that he was responsible for all trust company activities, including managing and monitoring existing accounts, compilation of the general ledger, asset management and account reconciliation.[6] The Department's examination report noted a number of deficiencies and/or violations and gave Sentinel a composite rating of "3".[7] The report further noted that since Sentinel was a "grandfathered" trust company, it had until three years after July 1, 1999, to come into compliance with the deficiencies/violations.[8]

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[4]R. Vol. I, 206.

[5]R. Vol. I, 9-41.

[6]R. Vol. I, 20, 23-24.

[7]All trust companies and bank trust departments in Tennessee are evaluated under the standards provided by the Uniform Interagency Trust Rating System. This system was initially adopted September 21, 1978 by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System, and in 1988 by the Office of Thrift Supervision. On October 5, 1998, the Federal Financial Institutions Examination Council ("FFIEC") approved and adopted revisions to the system. Under the current system, a trust company or department is evaluated in five component areas: management; operations, internal controls and audits; earnings; compliance; and asset management. The trust company is rated "1" to "5" (with "1" being best and "5" being worst) in these component areas in accordance with stated guidelines. The trust company is then given a composite rating of "1" to "5" (again, with "1" being best and "5" being worst).

[8]R. Vol. I, 17.

On November 2, 2000, the Department was made aware of a judgment in the amount of $2,226,047 that had been entered against Sentinel by the Davidson County Chancery Court on March 17, 2000 (*National Commerce Financial Bancorporation ("NCFB") v. Sentinel Trust Company*, Docket No. 97-2243-I).[9] The lawsuit alleged that Sentinel had breached its contractual fiduciary obligations as trustee under trust indentures securing certain private placement notes. President Bates had failed to disclose this judgment during the course of management's exit interview with the Department on May 31, 2000.[10] This judgment, if made final, would be well in excess of Sentinel's capital and would deem the company insolvent. Accordingly, on November 16, 2000, then Commissioner Bill Houston downgraded the company's December 31, 1999 examination Composite rating from a "3" to a "5".[11] Commissioner Houston also served a Cease and Desist Order upon Sentinel, which the Board agreed to the entry thereof.[12] Sentinel later settled the judgment for $575,000, which prevented the company from being declared insolvent.[13]

On January 26, 2001, the Department began an examination of Sentinel for the year ending December 31, 2000. The examination report found that President Bates continued to have virtually unrestricted access to all areas of the company with limited compensating controls established. The report found that there was no documentation of management's reconciliation

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[9]R. Vol. I, 58-59, 65, 189.

[10]R. Vol. I, 58, 189.

[11]R. Vol. I. 59, 65.

[12]*Id.*

[13]*Id.*

and review procedures and that President Bates was reconciling deposit accounts with no documented review by another party.[14] The report further noted that there were inconsistencies in the accuracy of the corporate and trust records and that there was no internal audit function in place.[15] Specifically, the report stated that "[r]econciling trust and corporate general records was difficult" and that "[t]he accuracy of reports appears suspect due to inconsistencies in totals, as well as, the varying formats and data processing systems used."[16] Finally, the report noted that guidelines and policies in regards to operations, internal controls, reconcilement of deposits and securities, balancing of accounts, information technology, audit function, investment management and contingency plan were all needed to provide supervision of Sentinel's corporate trust activities.[17]

Once again, Department examiners noted in the report that Sentinel was a "grandfathered trust" and, therefore, had until July 1, 2002 to come into complience with the deficiencies/violations noted in the report (many of which had been noted in the previous report).[18] The Department once again only gave Sentinel a composite rating of "3" on this examination report.[19]

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[14]R. Vol. 1, 62.

[15]R. Vol. 1, 63.

[16]R. Vol. 1, 71.

[17]R. Vol. I, 63, 71.

[18]R. Vol. 1, 63.

[19]R. Vol. 1, 64.

Additionally, because of a continued concern over the unreliability of Sentinel's corporate and fiduciary records, as well as management's inability or refusal to provide information documenting and supporting various entries on the Company's balance sheet, coupled with the type of fiduciary business the company administered, the report recommended that Sentinel be required to submit 90 day Progress Reports to the Department.[20]

On April 9, 2001, the Department received an application from Sentinel to amend its charter to change the principal office address to 29 West Main Street, Hohenwald, Tennessee; to delete the phrase "***but said corporation is not to carry on the business of banking***"; and, to state the authorized amount of shares to be 5,000,000.[21] The Department subsequently issued and recorded an amended and restated charter for Sentinel reflecting the above-requested changes.[22]

On April 22, 2002, the Department began its third annual examination of Sentinel. The report noted that the Board of Directors had adopted the Federal Deposit Insurance Corporation's Statement of Principle of Trust Department Management on September 21, 2000 as part of its Policy Manual.[23] The report further found, however, that President Bates was still primarily responsible for trust operations and continued to perform the majority of the corporate operation tasks himself.[24] The report also noted that Sentinel continued to operate without a formal internal

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[20]R. Vol. I, 107-108.

[21]R. Vol. I, 191.

[22]R. Vol. I, 192.

[23]R. Vol. I, 6-8, 129.

[24]R. Vol. I, 131

audit program and that President Bates continued to record and reconcile all depository accounts and do most of the corporate and fiduciary bookkeeping without any internal review.[25]

Additionally, the report raised the issue of the overdrafts in the accounts of the defaulted bond issues and noted that it was not clear as to how these overdrafts were funded, but that it appeared funds from other bond issues were being used. The report specifically reminded Sentinel's management of its duty "to keep trust account assets separate" and that the "funds of one bond issue are not be be used for another bond issue, nor are funds within the various bond issues to be used for anything other than their stated purpose."[26]

In addition, during the course of the examination, President Bates admitted that he had left $800,000 in assets off the Company's balance sheet when he had submitted the company's December 31, 2000 and December 31, 2001 Call Reports to the Commissioner. President Bates further admitted that this was done intentionally in an attempt to make Sentinel look less fiscally solvent than it actually was so as to obtain a lower settlement with NCFB.[27] As a result of this admission by President Bates and the submission by management of incorrect reports to the Commissioner, a Suspicious Activity Report was submitted in conjunction with the report.[28]

The April, 2002 examination report, which also covered the July 2002, October 2002 and January 2003 progress reports, was sent to Sentinel on February, 2003. In the cover letter, Commissioner Lavender specifically requested that management "provide information as to how

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[25]R. Vol. I, 132, 162.

[26]R. Vol. I, 134-35.

[27]R. Vol. II, 229-234.

[28] R. Vol. I, 162.

overdrafts are currently being funded for the various bond issues."[29] In response, President Bates sent a letter dated April 16, 2003 to the Commissioner, explaining funding of the overdrafts as follows:

> Fees and expenses are charged to the appropriate principal or income cash account of trust accounts as and when the fees and expenses are incurred. As a result, a cash overdraft will occur if payment is charged to an account holding little or no actual cash assets. In virtually all cases, however, the account will have non-cash assets in the process of being converted to cash and/or may hold collectible cash apart from the trustee. . . . Each trust account is separately identified and accounted for on a stand-alone basis. Cash and investment securities are collectively held for the individual accounts. Non-fungible assets such as real property, receivables and other pledged collateral are counted as nominal assets until converted into cash and received into the account. ***Fees and expenses are funded from collective cash assets and charged to appropriate individual trusts.***
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> When assets are converted to cash, the overdraft is liquidated. All trust accounts should hold assets in excess of any temporary cash overdraft. ***Sentinel recognizes that disbursements for a trust in excess of recoverable assets are to be recorded as a corporate expense. That has been and remains it corporate policy.***[30]

On June 13, 2003, the Department began an examination of Sentinel. On July 25, 2003, the Department was informed that Sentinel's audit firm, Charles Welch and Associates, had withdrawn and declined to complete Sentinel's December 31, 2002 audit, due to the inability to obtain from management evidence needed to evaluate the fair value of Sentinel's "corporate fiduciary receivables."[31] Subsequently, on July 30, 2003, President Bates confirmed that he had

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[29]R. Vol. I, 114.

[30]R. Vol. II, 227-228 (emphasis added).

[31]R. Vol I, 195; Vol. II, 250.

hired an independent CPA, Jim Brewer, to reconcile Sentinel's cash accounts, including the pooled fiduciary account.[32]

In light of this information, on August 8, 2003, the Department sent a memo to President Bates and the CPA, requesting explanations over several accounting issues that it had uncovered as the examination was proceeding.[33] One of the issues concerned the question of why the cash balance did not reconcile to either the fiduciary or corporate balance sheet totals or to the bank account statements.[34]

President Bates responded in two memoranda dated August 12 and 25, 2003.[35] In attempting to explain the discrepancies between the cash balance and the balance sheet totals and account statements, President Bates specifically stated that the "cash balance figure reported on the Trust Department Balance Sheet does not exist as an account register in AccuTrust which can be examined independently of the actual trust accounts. . . . To compensate for the lack of account registers in AccuTrust, transactions are posted independently in Quickbooks. At each month-end account records of AccuTrust and Quickbooks are compared and proofed. ***I believe our accounts are reconciled and balanced.***"[36] Additionally, President Bates provided an Account Reconciliation Report as of 5-31-2003.

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[32]R. Vol. I, 196.

[33]R. Vol. II, 250-252.

[34]*Id.*

[35]R. Vol. II, 253-255.

[36]R. Vol. II, 255 (emphasis added).

On October 6, 2003, the Commissioner met with the Board of Sentinel to inquire as to how expenses are funded by Sentinel for defaulted bond issues and to inform them of the urgency of the need for a financial statement audit of the company in order for the Commissioner to determine the solvency of the company.[37] Thereafter, on October 10, 2003, Petitioner Danny Bates, President of Sentinel, advised the Commissioner that Kraft CPAs, had been engaged to perform an audit for the year ending December 31, 2002.[38]

Subsequently on February 13, 2004, the Department had a discussion with Kraft CPA concerning their audit of Sentinel.[39] As a result of that discussion, the Department came to the tentative conclusion that Kraft would be opining that

> ***the company has contingent liabilities as it relates to their account receivables that are believed to be non-collectible and will therefore render the company insolvent.*** These receivables are believed to be losses in regard to expenses related to defaulted bond issues that the company has funded with monies from other non-related bond issues. Minimal losses have been reflected on corporate records despite President Bates stating that that is the policy and practice of the company. These receivable amounts have not been reported on company financials but instead are reflected on the Quickbooks fiduciary recordkeeping system. Examiners have routinely been given the AccuTrust fiduciary records for examination purposes which is also what is sent in for Call Report purposes. These contingent liabilities are estimated to be approximately $ 4 million to $ 4.8 million."[40]

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[37]R. Vol. I, 198-199.

[38]R. Vol. I., 199.

[39]R. Vol. II, 300-304.

[40]*Id.* (Emphasis added).

On March 19, 2004, the Department was provided with a copy of the audit report issued by Kraft.[41] In that report, Kraft identified approximately $9.4 million in fiduciary account receivables, of which approximately $7.5 million resulted from expenditures Sentinel had made in connection with defaulted bond issues and related unreimbursed costs and expenses. However, Kraft also stated in the report that the company's records had been inadequate for them to satisfy themselves as to the existence, amount or collectability of those receivables and, due to the materiality of this issue, Kraft declined to give an opinion as to the financial status of Sentinel as of December 31, 2002.[42] Kraft also noted in its letter to management that: (1) Trust Department and Company cash had been commingled in the same bank account; (2) the Company appeared to have paid company expenses from Trust Department accounts and reimbursed the Trust Department at a later date; and, (3) the Company had not been preparing an accurate reconciliation of the bank balance to the general ledger on a monthly basis, but was simply adjusting the general ledger balance to the bank's monthly balance which resulted in the company and the Trust Department significantly overstating cash as of December 31, 2002.[43]

After receiving this audit report, Department examiners returned to Sentinel on March 22, 2004, to review additional records and information.[44] Based upon the records provided at this visitation, the Department conducted a reconciliation of the balance of the fiduciary accounts as of December 31, 2003, as reflected in the AccuTrust System and the Quickbooks System, and the

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[41]R. Vol. I, 169-178.

[42]*Id.*

[43]R. Vol. I, 169-170.

[44]R. Vol. I, 201.

balance in the pooled fiduciary account (the SunTrust Account) as reconciled by the independant CPA, as well as the overdrafts on the defaulted bond issues shown in AccuTrust.[45] This reconciliation reflected a net cash shortage in the pooled fiduciary account of $5,789,011.[46]

Thereafter, on April 1, 2004, the Department examiners met with President Bates and an auditor from Kraft.[47] Prior to that meeting, President Bates had been provided with the reconciliation done by the Department and the determination of a net cash shortage of $5,789,011. During the meeting, President Bates was specifically asked if the Department's analysis and resulting determination of an approximately $5.7 million shortfall was incorrect. President Bates did not deny the accuracy of either, but instead, admitted this figure was close to the correct amount of the shortfall.[48] Furthermore, in addition to admitting the accuracy of the amount of the shortfall, neither President Bates, nor any other officer, director or employee of Sentinel, made any mention of a substantial amount of outstanding fees owed to Sentinel that would be available to offset this cash shortage.[49]

Thereafter, on April 5, 2004, the Commissioner sent a letter to Sentinel requesting an opinion of counsel regarding Sentinel's practice of funding defaulted bond expenses with funds from other non-related bond issues.[50] This practice, as understood by the Commissioner, was

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[45]R.Vol. I, 202; R. Vol. III, 630.

[46]*Id.*

[47]*See* Affidavit of Wade McCullough attached hereto as Exhibit 1 and incorporated herein by this reference. *See also*, R. Vol. I, 202-203.

[48]*See* Affidavit of Wade McCullough.

[49]*Id.*

[50]R. Vol. II, 306-308.

that Sentinel served as the indenture trustee for various high-yield, unregistered municipal and corporate bonds. In a number of instances, the debtor had failed to make the scheduled principal and/or interest payments and the bond had been declared in default per the terms of the indenture. Sentinel, in its role as indenture trustee, would then fund various expenses relative to these defaulted issues, such as insurance, security, legal and other professional fees, in an effort to protect the value of the underlying collateral. While the governing indenture and/or bondholder indemnification usually provided for the reimbursement of these expenses from the proceeds from the sale of the collateral, Sentinel did not have adequate corporate liquidity to fund these expenses, in the event that the defaulted issue did not already have sufficient funds on deposit with Sentinel. Thus, in order to fund these expenses, Sentinel would "borrow" from other non-related bond issues by writing checks and/or wires on its pooled demand deposit account at SunTrust Bank (hereinafter referred to as the "pooled fiduciary account"). This practice of "borrowing" from the pooled fiduciary account to fund the expenses of the defaulted issues resulted in the approximately $7.5 million in fiduciary account receivables that Kraft had been unable to substantiate as to their actual existence, amount or collectability.[51]

In response to the Commissioner's April 5 letter, Sentinel and its counsel requested a meeting with the Commissioner. On April 28, 2004, the Commissioner and members of his staff met with Sentinel's Executive Vice-President, Paul Williams, and Sentinel's attorneys, Alex Buchanan and David Lemke, with the firm of Waller, Lansden, Dortch & Davis, PLLC.[52] In that meeting, Sentinel's counsel indicated that Sentinel's practice of funding defaulted bond expenses

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[51] *Id.*

[52] R. Vol. II, 310, 316, 323.

with funds from other non-related bond issues was "inappropriate" and that such expenses were typically funded with corporate assets.[53]

On April 30, 2004, the Commissioner and his staff met with the board of Sentinel and its legal counsel. At that meeting, President Danny Bates admitted that his most recent calculations showed that Sentinel had a deficit fiduciary cash position of approximately $7.25 million, but that this figure fluctuated daily.[54] Mr. Bates made no mention, however, of the existence of outstanding substantial fees owed to Sentinel that would be available to offset the now $7.25 million fiduciary cash deficiency.[55] After this meeting, the Board adopted a new Corporate Trust Policy that specifically addressed the issue of funding expenses of defaulted bond issues.[56] The policy provides, among other things, that in order to avoid the loss of collateral or senior secured position, "advances may be made up to the expected liquidation value," but that "[f]unds may not be advanced from any trust account if it is anticipated that the advance creates an overdraft in the affected account."[57]

As a result of President Bates' admissions, on May 3, 2004, the Commissioner issued an Emergency Cease and Desist Order and Notice of Charges against Sentinel, pursuant to Tenn. Code Ann. §§ 45-1-107(a)(4), (5) and (c).[58] The Order and Notice declared that the

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[53]R. Vol. II, 316, 323.

[54]R. Vol. I, 203; Vol. II, 317, 323.

[55]*See* Affidavit of Wade McCullough.

[56]R. Vol. II, 350-353.

[57]R. Vol. II, 351.

[58]R. Vol. II, 311-337.

Commissioner had determined that Sentinel was operating in an unsafe and unsound manner and ordered Sentinel, among other things, to make an initial infusion of capital in the amount of $2 million by the close of business on May 17, 2004, to partially replinish the fiduciary cash deficiency. The order further directed Sentinel to submit a capital plan outlining the Company's plans to completely replenish the fiduciary pooled account and to outline the steps to be taken to provide sufficient operating capital.[59]

On May 6, 2004, Sentinel's then legal counsel advised the Board of Sentinel of its recommendation that it was in the best interests of the company for the Board to ask President Bates to resign as an officer and director of the Company.[60] Legal counsel further advised the Board that if President Bates did not voluntarily resign, they would have to resign as counsel to the Company.[61] President Bates refused to resign and counsel subsequently resigned from its representation of Sentinel.

On May 17, 2004, the Commissioner and his staff met with Sentinel's new legal counsel, Mary Neil Price with the firm of Miller and Martin. At that meeting, Sentinel's counsel admitted that Sentinel had not provided the Commissioner with a capital plan[62] because they did not have a "good enough handle on the financial situation."[63] However, prior to this meeting, Sentinel's counsel had provided an outline of steps that Sentinel proposed to take that they believed would

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[59]*Id.*

[60]R. Vol. II, 370.

[61]*Id.*

[62]Sentinel had submitted a Capital Adequacy Plan to the Department on May 3, 2004, but withdrew it that same day. *See* R. Vol. I, 204; R. Vol. II, 339-342.

[63]R. Vol. III, 453-455.

"improve Sentinel's financial position and [to] maximize funds available to repay any deficits in any default trust accounts for which funds are not available from other sources."[64] These steps included: (1) certain actions to reduce Sentinel's operating expenses; (2) an attempt to accelerate collection of advanced expenses on the defaulted bond issues; and (3) the financing of real property owned by Sentinel.[65] Nowhere in this proposal was there any mention, though, of the existence of substantial fees (default and administrative) owed to Sentinel that would be available to "maximize funds available to repay any deficits in any default trust accounts."

In addition to failing to provide a capital plan, Counsel indicated that Sentinel's management was only willing to make a total capital infusion of $225,000 instead of the $2 million directed by the Commissioner.[66]

In light of Sentinel's failure to comply with the primary directives of the Order and Notice, and in light of the record as a whole, the Commissioner determined that the only appropriate action necessary to protect the bond issuers and bondholders was to take possession of Sentinel. Accordingly, on May 18, 2004, the Commissioner took emergency possession of Sentinel pursuant to Tenn. Code Ann. §§ 45-2-1502(b)(1) and (c)(1).[67] That same day, the Commissioner issued an order appointing Receivership Management, Inc., to act as the Receiver of Sentinel, pursuant to Tenn. Code Ann. § 45-2-1502(b)(2).[68]

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[64]R. Vol. III, 446-451.

[65]*Id.*

[66]*Id.*

[67]R. Vol. III, 464-465.

[68]R. Vol. III, 466-476.

Upon taking possession, the Receiver and Department personnel immediately began reviewing and analyzing Sentinel's books and records in an attempt to determine the true financial status of the company, including the extent of the shortfall in the pooled fiduciary account, as of the date of possession (May 18, 2004). This determination was hampered by the fact that Sentinel was using two different accounting systems — Quick Books and AccuTrust fiduciary accounting system — and that entries in these two systems were not consistently reconciled with each other or with the bank statements from the pooled fiduciary account.[69]

On June 15, 2004, the Receiver and Department personnel issued a preliminary report ("the Report") on the fiduciary and corporate financial positions of Sentinel, based upon a review of Sentinel's own records.[70] Those records reflected, as set forth in the Report, that as of December 31, 2003, Sentinel had a cash deficiency or shortfall in the pooled fiduciary account of $5,789,011.00. That cash deficiency in the pooled fiduciary account increased over the next four months such that by May 18, 2004, the deficiency ranged from $7,612,218.00 in Quick Books to $8,430,722.00 in the AccuTrust fiduciary accounting system. In addition, the Receiver and Department personnel had discovered bond principal and interest checks in Sentinel's vault totaling $861,107.11.[71] Thus, Sentinel's cash deficiency in the pooled fiduciary account should actually be increased by the amount of these checks such that the cash deficiency ranges from between $7,913,451.11 to $8,731,956.11.

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[69]R. Vol. III, 603.

[70]R. Vol. III, 623-41.

[71]*Id.* Since the issuance of the report on June 15, 2004, the Receiver and Department staff have found additional principal and interest checks increasing the total amount to $861,107.11. To date, demands totaling $105,000 for bond principal checks have been received. *See* Affidavit of Wade McCullough, Exhibit 1.

The report also reflected, based upon Sentinel's own records, that for the first four and a half months of 2004, Sentinel operated with a net loss of $197,917.00.[72] Finally, the report showed that as of May 18, 2004, Sentinel had total corporate assets of $1,389,682. Thus, taking into account the cash deficiency in the pooled fiduciary account (which is reflected as an accounts payable), the report determined that Sentinel was insolvent in an amount of at least $6,225,445 as of May 18, 2004.[73]

On June 17, 2004, the Commissioner and members of his staff met with Petitioner Danny Bates, and his attorney, Carroll Kilgore.[74] At that meeting, Mssrs. Bates and Kilgore were presented with a copy of the Report for their review and given the opportunity to discuss the Report with the Commissioner and his staff. Mssrs. Bates and Kilgore were also given the opportunity to submit a written response to the Report prior to the Report being made public and/or any action taken by the Commissioner with respect to the Report. Neither Mr. Bates nor Mr. Kilgore had any substantive comments to make with respect to the Report during the meeting with the Commissioner, nor did they submit any written response.[75]

In light of the Report's determination that Sentinel was insolvent in an amount of at least $6,225,000; that Sentinel did not have sufficient liquid assets to pay off its bondholders and creditors; did not have a viable plan for the infusion of sufficient capital to eliminate the $7.6-

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[72]R. Vol. III, 634.

[73]R. Vol. III, 633. This insolvency does not include the $861,107.11 in bond principal and interest checks discussed, *supra*, which increases the fiduciary cash deficiency, and would increase the insolvency by a corresponding amount.

[74]R. Vol. III, 601.

[75]*Id.*

$8.4 million cash deficiency in the pooled fiduciary account; and the record as a whole, the Commissioner determined that liquidation of Sentinel in accordance with the provisions of Tenn. Code Ann. §§ 45-2-1502(c)(2) and 1504 was necessary and appropriate.[76] Accordingly, on June 18, 2004, the Commissioner issued a Notice of Liquidation of Sentinel Trust Company.[77]

Petitioners did not file their Petition for common law writ of certiorari seeking supervisory judicial review of the Commissioner's decision to take possession of Sentinel Trust Company until June 29, 2004, over six weeks after the Commissioner had taken possession and over a week after the Commissioner had determined to liquidate the company.

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[76]R. Vol. III, 644-646.

[77]*Id.*

II. STANDARD OF REVIEW FOR COMMON LAW WRIT OF CERTIORARI

The scope of review under the common law writ is very narrow. The common law writ does not permit the reviewing court to inquire into the intrinsic correctness of the inferior board or tribunal's judgment as to the law or the facts.[78] Rather, judicial review is of the manner in which the decision of the inferior board or tribunal was reached and not the correctness of the decision itself.[79] Thus, the scope of review covers only an inquiry into whether the inferior board or tribunal has exceeded its jurisdiction, followed an unlawful procedure, acted illegally, fraudulently, or arbitrarily or acted without material evidence to support its decision.[80] "Exceeding the jurisdiction conferred" and "acting illegally" both refer to actions that are beyond, and not within, the jurisdiction of the inferior board or tribunal.[81] Moreover, illegal

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[78] *Cooper v. Williamson County Bd. of Educ.*, 746 S.W.2d at 176, 179 (Tenn. 1987); *McCord v. Nashville, C & St. L. Ry.*, 187 Tenn. 277, 294, 213 S.W.2d 196, 204 (1948); *Littles v. Campbell*, 97 S.W.3d 568, 571 (Tenn. Ct. App. 2002); *Hall v. McLesky*, 83 S.W.3d 752, 757 (Tenn.Ct.App. 2001); *Yokley v. State*, 632 S.W.2d at 126 (Tenn. Ct. App. 1981). *See also Pack v. Royal-Globe Ins. Companies*, 224 Tenn. at 456, 457 S.W.2d at 25 (1970); *Henry v. Board of Claims*, 638 S.W.2d 825, 827 (Tenn. Ct. App. 1982), *cert. denied* (1982)(Chancellor's actions in reviewing intrinsic correction of Board's decision exceeded power and jurisdiction under common law writ of certiorari); and *Yearwood v. Industrial Develop. Bd. of City of White House*, 648 S.W.2d 944, 946 (Tenn. Ct. App. 1982) *cert. denied* (1983)("The writ has never been employed to inquire into the correctness of the judgment rendered where the court had jurisdiction and was therefore competent.").

[79] *Powell v. Parole Eligibility Review Board*, 879 S.W.2d at 873 (Tenn. Ct. App. 1994). *See also State ex rel. McMorrow v. Hunt*, 137 Tenn. at 250-51, 192 S.W. at 933 (1916); *Davis v. Rose*, App. No. 01A01-9610-CH-00494 (1997 WL 83671), slip op.at 2 (Feb. 28, 1987)(held that categories of "illegal, fraudulent or arbitrary, or in excess of its jurisdiction" all stand for the principle that what is being challenged is not the intrinsic correctness of the lower court's decision, but some fundamental flaw in the manner in which that decision was reached)(copy attached); and *Fox v. Tennessee Board of Paroles*, App. No. 01A019506CH00263 (1995 WL 681135), slip op.at 2 (Nov. 17, 1995)(common law writ permits court to review manner in which board reached its decision but not to review intrinsic correctness of decision itself)(copy attached).

[80] *Fallin v. Knox County Bd. of Comm'rs*, 656 S.W.2d 338, 342-343 (Tenn. 1983); *Hutcherson v. Lauderdale County Bd. of Zoning App.*, 121 S.W.3d 372, 375 (Tenn. Ct. App. 2002); *421 Corp. v. Metropolitan Gov't*, 36 S.W.3d 469, 474 (Tenn.Ct.App. 2000); *Powell v. Parole Eligibility Review Board*, 879 S.W.2d 871, 873 (Tenn. Ct. App. 1994), *cert. denied* (1994)(citing *Yokley v. State*, 632 S.W.2d 123 (Tenn. Ct. App. 1981).

[81] *"Pack v. Royal-Globe Ins. Companies*, 224 Tenn. 452, 456, 457 S.W.2d 19, 25 (1970).

actions subject to correction through a common-law writ of certiorari must rise to the level of a fundamental illegality,[82] or a failure to proceed according to the essential requirements of the law.[83]

Additionally, judicial review under the common-law writ is limited to the record made before the board or inferior tribunal to determine if there is any material or substantial evidence to support the action of the board or inferior tribunal or if it exceeded its jurisdiction or acted in an illegal, arbitrary or capricious manner.[84] The reviewing court does not determine any disputed question of fact or weigh any evidence, nor may it engage in weighing or balancing the evidence when determining whether the board's decision rests on any material or substantial evidence.[85] Further, the reviewing court does not substitute its judgment for that of the board or inferior tribunal.[86]

"Material evidence" has been defined as that "material in question, which must necessarily enter into the consideration of the controversy and by itself, or in connection with the

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[82]*State ex rel. McMorrow v. Hunt*, 137 Tenn. 243, 249, 192 S.W. 931, 933 (1916).

[83]*Taylor v. Continental Tenn. Lines, Inc.*, 204 Tenn. 556, 560, 322 S.W.2d 425, 426-27 (1959); *Gatlinburg Beer Regulation Comm. v. Ogle*, 185 Tenn. 482, 486, 206 S.W.2d 891, 893 (1947).

[84]*Cooper v. Williamson County Bd. of Educ.*, 746 S.W.2d 176, 179 (Tenn. 1987); *Davison v. Carr*, 659 S.W.2d 361, 363 (Tenn. 1983); *City of Chattanooga v. Tennessee Alcoholic Beverage Commission*, 525 S.W.2d 470, 478 (Tenn. 1975); *Hoover Motor Express v. Railroad and Public Utilities Commission*, 195 Tenn. 593, 604-605, 261 S.W.2d 233, 238 (1953); and, *Houston v. Memphis and Shelby County Bd. of Adjustment*, 488 S.W.2d 387, 388 (Tenn. Ct. App. 1972).

[85]*Watts v. Civil Serv. Bd. for Columbia,* 606 S.W.2d 274, 277 (Tenn. 1980); *Tennessee Cartage Co. v. Pharr*, 184 Tenn. 414, 419, 199 S.W.2d 119, 121 (1947); *Case v. Shelby County Civil Serv. Merit Bd.*, 98 S.W.3d 167, 172 (Tenn.Ct.App. 2002); *Hoover, Inc. v. Metropolitan Bd. of Zoning App.*, 924 S.W.2d 900, 904 (Tenn.Ct.App. 1996).

[86]*421 Corp. v. Metropolitan Gov't*, 36 S.W.3d at 474; *Whittemore v. Brentwood Planning Comm'n*, 835 S.W.2d 11, 15 (Tenn. Ct. App. 1992).

other evidence, be determinative of the case."[87] "Substantial evidence" has been defined as such evidence as reasonable minds might accept as adequate to support a conclusion.[88] "Substantial evidence" has also been defined as being "something less than the weight of the evidence, and the possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency's finding from being supported by substantial evidence."[89]

Thus, Tennessee courts have held that under the common law writ of certiorari

> it matters little that there may be evidence to support a conclusion contrary to that reached by the Board. Its makes no difference if the Board's decision is or is not correct. So long as there is any material and substantial evidence to support the Board's decision, the Board's decision will be affirmed.[90]

As such, an erroneous decision of the interior board or tribunal, or a misapplication of a principle of law, absent more, is not considered illegal, arbitrary or capricious.[91]

The specific legal arguments raised by Petitioners should be considered with this standard of review in mind.

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[87] *Knoxville Traction Co. v. Brown*, 115 Tenn. 323, 331, 89 S.W. 319, 321 (1905); *Fuller v. Tennessee-Carolina Transportation Co.*, 63 Tenn.App. 330, 338, 471 S.W.2d 953, 956 (1970).

[88] *Rice Bottling Co. v. Humphries*, 213 Tenn. 8, 11, 372 S.W.2d 170, 172 (1963).

[89] *Hendricks v. Metropolitan Employee Benefit Board*, App. No. 01A01-9203CH00130 (1992 WL 279880), slip op.at 3 (Oct. 14, 1992)(copy attached).

[90] *Id.*

[91] *See Henry v. Board of Claims,* 638 S.W.2d at 827 (1982)("We do not believe that a misapplication of a principle of law by the Board will invoke a right to review of its findings by the common law writ of certiori."); *Purcell Enterprises, Inc. v. State*, 631 S.W.2d 401, 405 (Tenn. Ct. App. 1981), *cert. denied* (1982)("interpretation by the board of the equitable adjustments clause was erroneous, but not arbitrary, capricious or illegal . . . the board of claims either made a mistake of fact or a mistake of law, or both. From such erroneous interpretation, . . . there is no review in the courts pursuant to the writ of certiorari."); and *Yokley v. State*, 632 S.W.2d at 127 (Tenn. Ct. App. 1981)(misapplication or error of law is not illegal, arbitary or capricious).

III. ARGUMENT

A. The Commissioner Did Not Exceed His Jurisdiction Or Act Illegally In Taking Possession Of Sentinel Trust Company.

Petitioners' Petition for Writ of Certiorari rests primarily upon their assertion that since "no statute provides that the term "bank" includes "trust company" with reference to any other provisions of the Tennessee Banking Act", the Commissioner has no authority to exercise any of his "bank regulatory powers" against Sentinel, a non-banking trust company, including Tenn. Code Ann. § 45-2-1502 which authorizes the Commissioner to take possession of a state bank in certain circumstances.[92] Instead, Petitioners assert that the Commissioner only has

> the general power to enforce applicable laws against trust companies, including both statutes applicable by their terms only to trust companies (*supra*, ¶ 7), and statutes in the Tennessee Banking Act concerning fiduciary functions which, by their explicit terms, are applicable both to trust companies and to banks authorized to exercise fiduciary powers, T.C.A. §§ 45-2-1002-1006.[93]

Accordingly, Petitioners assert that the Commissioner exceeded his jurisdiction and/or acted illegally when he took possession of Sentinel pursuant to the provisions of Tenn. Code Ann. § 45-2-1502, as that statute only speaks in terms of "state banks".

Petitioners' argument is entirely disingenuous and ignores the the specific directives of the Tennessee General Assembly that trust companies be fully regulated by the Commissioner and subject to all the requirements of the Tennessee Banking Act, codified in chapters 1 and 2 of Title 45 of the Tennessee Code. That Act was first adopted by the General Assembly in 1969

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[92]Petition at ¶ 9.

[93]*Id.*

and only directed that all state banks be operated in accordance with its provisions.[94] In 1980, the General Assembly amended the Act to expand the scope of its application, providing as follows:

> provided, however, a state bank or trust company whose purposes and powers are limited to fiduciary purposes and powers shall be subject only to the provisions pertaining to fiduciaries in Chapters 1 through 11 of this title and such other provisions of said chapters as the Commissioner determines are reasonably necessary for the sound operation of such banks or trust companies.[95]

The General Assembly further provided that "[n]o trust company hereafter may be incorporated or be qualified to act as a fiduciary unless it is incorporated under Chapters 1 through 11 of this title, or the laws governing national banking associations."[96]

Had the Banking Act remained unchanged since the adoption of Chapter 620 in 1980, Petitioners' assertion that the Commissioner only has the power to enforce statutes in the Tennessee Banking Act concerning fiduciary functions might have some validity.[97] However, the Banking Act did not remain unchanged. In 1999, the General Assembly amended the Act to specifically make trust companies subject to all of its provisions, and not just those pertaining to fiduciaries. Section 3 of Chapter 112 of the Public Acts of 1999 amended Tenn. Code Ann. § 45-1-124(b) by deleting that subsection and substituting the following:

> (b) To the full extent consistent with such rights, liabilities and penalties, all state banks and, to the extent applicable, all banks, shall hereafter be operated in accordance with the provisions of this

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[94]*See* Public Acts 1969, Chap. 36, § 1.104 (copy attached).

[95]*See* Public Acts 1980, Chap. 620, § 3 (copy attached), codified at Tenn. Code Ann. § 45-1-124.

[96]*Id.* at § 4.

[97]It should be noted, however, that even under the 1980 Act, the General Assembly gave the Commissioner the authority and the discretion to enforce other provisions of the Banking Act that he determines are reasonably necessary for the sound operation of trust companies.

chapter and Chapter 2 of this title. ***Unless the Commissioner determines otherwise, the provisions of Title 45, Chapters 1 and 2 and the rules thereof shall also apply to the operation and regulation of state trust companies and banks whose purposes and powers are limited to fiduciary purposes and powers.***

Section 4 of Chapter 112 further amended Tenn. Code Ann. § 45-1-124 to add the following new subsection:

> ( ) The charter of a trust company granted by the commissioner shall not be void due to the enactment of any amendment or repeal of the laws under which it was formed if such trust company is in operation, as determined by the commissioner, on July 1, 1999.
>
> ( ) Companies engaged in activities subject to Title 45, Chapters 1 and 2, on July 1, 1999, but formed, as determined by the commissioner, prior to the enactment of Chapter 620 of the Public Acts of 1980 and not previously subject to regulation by the commissioner may continue to act as a fiduciary without submitting an application. ***However, such entities shall otherwise be fully subject to Chapters 1 and 2.***
>
> ( ) Companies authorized by their charter, prior to the enactment of Chapter 620, to engage in fiduciary activities, but not engaging in fiduciary activities on July 1, 1999, then must file the appropriate application to establish a trust company and ***then fully comply with Chapters 1 and 2.***
>
> ( ) ***All state trust companies operating on July 1, 1999, shall have such period of time as the commissioner determines to be reasonable and prudent to conform to the requirements of Chapters 1 and 2 and the regulations thereunder, but such period shall not exceed three (3) years from July 1, 1999.*** During this period of time, to conform to the requirements of Chapters 1 and 2, the commissioner may conduct examinations at such company's expenses, and apply the requirements of Chapters 1 and 2 as deemed appropriate.[98]

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[98]*See* Public Acts of 1999, Chap. 112, § 4 (emphasis added) (copy attached).

These provisions of Chapter 112 make it unmistakably clear the General Assembly's intent that ***all*** of Chapters 1 and 2 of Title 45 ***shall*** apply to the operation and regulation of state trust companies, and that such companies shall fully comply and conform with all the provisions of these chapters, and not just the provisions pertaining to fiduciary activities.

The Commissioner took possession of Sentinel pursuant to the provisions of Tenn. Code Ann. § 45-2-1502, which provides in part as follows:

> (a) The commissioner may take possession of a state bank if, after a hearing, the commissioner finds:
>
> (1) Its capital is impaired or it is otherwise in an unsound condition;
>
> (2) Its business is being conducted in an unlawful or unsound manner;
>
> (3) It is unable to continue normal operations; or
>
> (4) Its examination has been obstructed or impeded.
>
> * * *
>
> (c)(1) If, in the opinion of the commissioner, an emergency exists which will result in serious losses to the depositors, the commissioner may take possession of a state bank without a prior hearing. Any person aggrieved and directly affected by this action of the commission may have a review by certiorari as provided in title 27, chapter 9.

Petitioners make the novel argument that because this statute speaks only in terms of a state bank and its depositors, and since Sentinel is neither a state bank nor does it have any deposits/depositors, this statute does not apply to Sentinel and, therefore, the Commissioner acted illegally or exceeded his authority when he took possession of Sentinel pursuant to this statute. This argument is directly contrary, however, to the clearly expressed intent of the General Assembly as set forth in Chapter 112. As discussed, *supra*, that act specifically states that "***the provisions of Title 45, Chapters 1 and 2 and the rules thereof shall also apply to the***

operation and regulation of state trust companies and banks whose purposes and powers are limited to fiduciary purposes and powers."[99] Tenn. Code Ann. § 45-2-1502 clearly is a provision contained within Chapter 2 of Title 45 and, therefore, applies to the operation and regulation of Sentinel Trust Company. As such, the Commissioner acted with express statutory authority in taking possession of Sentinel pursuant to Tenn. Code Ann. § 45-2-1502.

Furthermore, Petitioners' argument that since it is not a bank and, therefore, the Commissioner only has the statutory authority to enforce statutes with respect to its fiduciary activities is directly contrary to Petitioners' own actions. Specifically, in April of 2001, Petitioners submitted an application to the Commissioner, pursuant to Tenn. Code Ann. § 45-2-218, to amend the charter of Sentinel.[100] That statute speaks only in terms of a "state bank" and provides in pertinent part as follows:

> (a) A ***state bank*** shall apply to the commissioner to amend its charter or to change its location or the location of any of its branches. Any such change of location shall be consistent with the provisions of § 45-2-614.
> (b) An application for an amendment of the charter shall be authorized by the vote of at least a majority of the outstanding voting stock at a meeting of stockholders.
> * * *
> (e) Any amendment to the charter of an ***incorporated bank*** increasing or decreasing its capital stock or otherwise must be recorded in accordance with § 45-2-205(c). (Emphasis added).

Petitioners' application to amend Sentinel's charter sought not only to change the principal office to 29 West Main Street, Hohenwald, Tennessee, but to also delete the language

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[99]*See* Tenn. Code Ann. § 45-2-124(b) (emphasis added).

[100]A copy of this Application and Amended and Restated Charter are attached hereto as Collective Exhibit 2 and incorporated herein by this reference. *See also*, R. Vol. 1, 191-192.

"***but said corporation is not to carry on the business of banking***" from the charter, and to state the authorized amount of shares to be 5,000,000.[101] The Commissioner subsequently issued an amended and restated charter to reflect the changes and filed it in accordance with the requirements of Tenn. Code Ann. § 45-2-205(c).[102] Thus, for Petitioners to now assert that they are not subject to the provisions of Tenn. Code Ann. § 45-2-1502 because it only references "state banks" is contrary to their own actions.

Accordingly, Petitioners' assertion that the Commissioner acted illegally and in excess of his jurisdiction in taking possession of Sentinel is without merit and should be dismissed in its entirety.

B. Tenn. Code Ann. § 45-2-1502 Authorizing the Commissioner To Take Possession Of Sentinel Is Not Unconstitutional.

Petitioners have also made a number of arguments all of which appear to attack the constitutionality of Tenn. Code Ann. § 45-2-1502, which authorized the Commissioner to take possession of Sentinel Trust Company. First, Petitioners assert that to the extent this statute authorizes the Commissioner to assume Sentinel's contractual obligations and rights to control all trust funds in its accounts by virtue of its status as Trustee and Paying Agent, it is in violation of the prohibition against the impairment of contractual obligations contained in Art. I, § 20 and Art. XI, § 16 of the Tennessee Constitution and Art. 1, § 10 of the United States Constitution.[103] Next, Petitioners argue that this statute violates Art. I, § 8 and Art. XI, § 16 of the Tennessee

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[101] *Id.* (Emphasis added).

[102] *Id.*

[103] Petition at ¶ 10(a).

Constitution and the Fifth and Fourteenth Amendments to the United States Constitution in that it authorizes the Commissioner to seize the property of Sentinel and the property of bond-holders and bond issuers held in trust without just compensation.[104] Finally, Petitioners assert that Tenn. Code Ann. § 45-2-1502 violates the separation of powers provision of Art. II, § 2 of the Tennessee Constitution in that it allows the Commissioner to place a trust company in receivership, which they assert is a judicial power vested solely in the Courts of Tennessee.[105]

All of these arguments concerning the constitutionality of Tenn. Code Ann. § 45-2-1502 are without merit and should also be dismissed in their entirety.

1. Impairment of Contracts

Art. I, § 10, cl. 1 of the United States Constitution and Art. I, § 20 of the Tennessee Constitution provide as follows:

> § 10. Powers denied the states. - [1.] No state shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make any thing but gold and silver coin a tender in payment of debts; ***pass any bill of attainder, ex post facto law or law impairing the obligation of contracts***, or grant any title of nobility.[106]
>
> Sec. 20. No retrospective laws. - That no retrospective law, or law impairing the obligations of contracts shall be made.[107]

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[104] *Id.* at ¶ 10(b).

[105] *Id.* at ¶ 10(c).

[106] Art. 1, § 10, cl. 1 of the United States Constitution (emphasis added).

[107] Art. 1, § 20 of the Tennessee Constitution.

These constitutional provisions do not proscribe all retrospective laws, but rather proscribe only those laws that divest or impair vested substantive or contractual rights.[108] "Vested rights" are defined by the Tennessee Supreme Court as including those "which it is proper for the State to recognize and protect and of which the individual should not be deprived arbitrarily without injustice."[109] The Tennessee Supreme Court has further held that in order to be protected by Art. I, § 20, a "contract right" must be legally enforceable and must not conflict with the constitution, the statutes, or the common law.[110] Thus retrospective laws are those "which take away or impair vested rights acquired under existing laws or create a new obligation, impose a new duty, or attach a new disability in respect of transactions or considerations already passed."[111]

Initially, it should be noted that Petitioners have failed to identify any vested or contractual rights in their petition other than to make the general assertion with respect to Sentinel's "contractual obligations and rights to control all trust funds in its bank accounts by virtue of its status as Trustee and Paying Agent."[112] Moreover, Tenn. Code Ann. § 45-2-1502 clearly does not constitute a retrospective law, as Sentinel had no vested or contractual rights at the time this statute was passed by the Legislature. Tenn. Code Ann. § 45-2-1502 was enacted

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[108]*Hanover v. Ruch*, 809 S.W.2d 893, 896 (Tenn. 1991); *Miller v. Sohns*, 225 Tenn. 158, 162, 464 S.W.2d 824, 826 (Tenn. 1972); *Dark Tobacco Growers' Co-op Ass'n v. Dunn*, 150 Tenn. 614, 632, 266 S.W. 308, 312 (1924).

[109]*Morris v. Gross*, 572 S.W.2d 902, 905 (Tenn. 1978).

[110]*Spiegel v. Thomas, Mann & Smith, P.C.*, 811 S.W.2d 528, 530 (Tenn. 1991). *See also, Lazenby v. Universal Underwriters Ins. Co.*, 214 Tenn. 639, 648, 383 S.W.2d 1, 5 (1964) (recognizing that contracts that conflict with constitutions, statutes, or the common law violate public policy and are unenforceable).

[111]*Morris v. Gross*, 572 S.W.2d at 907.

[112]Petition at ¶ 10(a).

by the Tennessee General Assembly in 1969 as part of the Tennessee Banking Act.[113] Sentinel's corporate charter authorizing it to act and engage in business as a trust company was not even issued until 1975.[114] Thus, at the time that Tennessee enacted the statute in question, Sentinel did not have — and could not have had — any vested or contractual right that was impaired because it did not even exist until seven (7) years after the enactment of this statute.

Furthermore, it is well settled that all laws in force when a contract is made, which affect its validity, construction, duration, discharge, evidence or enforcement, constitute a part of its obligation and are as much a part of it as if expressed in its stipulation.[115] Consequently, at the time that Sentinel entered into any contracts to act as Trustee and/or Paying Agent, the provisions of Tenn. Code Ann. § 45-2-1502 were in force and, therefore, were made as much a part of that agreement as if expressed therein.[116] Accordingly, Tenn. Code Ann. § 45-2-1502 does not unconstitutionally impair any vested substantive or contractual rights of Sentinel.

2. Taking Without Just Compensation

The Takings Clause of the Fifth Amendment provides that no "private property [shall] be taken for public use, without just compensation." Initially, it should be noted that Tenn. Code Ann. § 45-2-1504, which governs the liquidation of a trust company in the Commissioner's

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[113] *See* Public Acts of 1969, chap. 36, § 3.504 (copy attached).

[114] *See* Petition at ¶ 7.

[115] *Woodfin v. Hooper* 23 Tenn. (4 Humph.) 13 (1843); *Hannum v. McInturff*, 65 Tenn. (6 Baxt) 225 (1873); *Robbins v. Life Ins. Co.*, 169 Tenn. 507, 89 S.W.2d 340 (1936); and, *Cary v. Cary*, 675 S.W.2d 491, 493 (Tenn. Ct. App. 1984). *See also, Von Hoffman v. City of Quincy*, 4 Wall. 535, 550, 18 L.Ed. 403 (1868); *Walker v. Whitehead*, 83 U.S. 314, 21 L.Ed. 357 (1873); and, *Antoni v. Greenbow*, 107 U.S. 769, 27 L.Ed. 468 (1883).

[116] *See Security Pacific Equipment Leasing, Inc. v. FDIC*, App. No. E1999-00270-COA-R3-CV (2000 WL 145078), slip op. at 12 (Feb. 9, 2000) (copy attached).

possession, provides in subsection (i) that "[a]ny assets remaining after all claims have been paid shall be distributed to the stockholders in accordance with their respective interests." In light of this provision, the Commissioner submits that there simply has been no "taking" of private property.

Moreover, the United States Supreme Court has held that the "taking" of private property under the exercise of governmental authority other than the power of eminent domain does not violate the Takings Clause.

> The government may not be required to compensate an owner for property which it has already lawfully acquired under the exercise of governmental authority other than the power of eminent domain.[117]

Here, to the extent that the Commissioner has "acquired" any property, it was pursuant to the exercise of his authority in the Banking Act, and not pursuant to any powers of eminent domain. Furthermore, federal courts have specifically held that the appointment of a receiver for a savings and loan association was not a compensable taking under the Fifth Amendment, as neither the association nor its owner had a historically rooted expectation of compensation from such seizure, considering the regulated environment in which the association voluntarily operated.[118] Similarly, Petitioners cannot have the necessary historically rooted expectation of compensation, in light of the regulated environment in which they have voluntarily operated. As such, there can be no claim of an unconstitutional taking.

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[117]*Bennis v. Michigan*, 516 U.S. 442, 452, 116 S.Ct. 994, 1001, 134 L.Ed.2d 68 (1996)(citing *United States v. Fuller*, 409 U.S. 488, 492, 93 S.Ct. 801, 804, 35 L.Ed.2d 16 (1973); *United States v. Rands*, 389 U.S. 121, 125, 88 S.Ct. 265, 268, 19 L.Ed.2d 329 (1967)).

[118]*California Housing Securities, Inc. v. United States*, 959 F.2d 955 (Fed. Cir. 1992).

3. Separation of Powers

The Tennessee Constitution states that "[t]he powers of the government shall be divided into three distinct departments: the Legislative, Executive and Judicial," and that "[n]o person or persons belong to one of these departments shall exercise any of the powers properly belonging to either of the others, except in the cases herein directed or permitted."[119] The Tennessee Constitution does not define the powers of each department in express terms.[120] However, the Tennessee Supreme Court has restated a simplified description of each of these roles when it noted that "[t]he legislative branch has the authority to make, alter, and repeal the law; the executive branch administers and enforces the law; and the judicial branch has the authority to interpret and apply the law."[121]

While the departments of government have been characterized as "independent" and "co-equal,"[122] they have also been viewed as "interdependent" because their functions overlap.[123] Thus, while the doctrine of separation of the powers, as set out in Article II, §§ 1 and 2, is a fundamental principle of American constitutional government, it has long been recognized that it is impossible to preserve perfectly the theoretical lines of demarcation between the executive,

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[119]Tennessee Constitution, Art. II, §§ 1 and 2.

[120]*See* Art. II, § 3, which vests all legislative authority in the General Assembly; Art. III, § 1, which vests the executive power in the Governor; and Art. VI, § 1, which vests the judicial power in the Supreme Court and the circuit, chancery and other courts established by the General Assembly.

[121]*Richardson v. Tennessee Bd. of Dentistry*, 913 S.W.2d 446, 453 (Tenn. 1995).

[122]*Mayhew v. Wilder*, 46 S.W.3d 760, 783 (Tenn.Ct.App.), *p.t.a. denied* (2001)(citing *Summers v. Thompson*, 764 S.W.2d 182, 189 (Tenn. 1988); *Moore v. Love*, 171 Tenn. 682, 686-87. 107 S.W.2d 982, 983-84 (1937)).

[123]*Id.* (citing *State v. King,* 973 S.W.2d 586, 588 (Tenn. 1998); *Underwood v. State*, 529 S.W.2d 45, 47 (Tenn. 1975)).

legislative and judicial branches of government.[124] As the Tennessee Supreme Court noted in *Richardson v. Young*:

> There are also some powers which, on account of the complexity of governmental functions, are difficult to classify, and may be, with equal propriety and correctness, committed to more than one department. . . .
> There are many acts possessing a legislative, executive or judicial character, especially peculiar to the very nature of our system, and necessarily inherent in it. Which time out of mind have not been exclusively exercised by these departments, and which, for the ease and efficiency of our system, could not be so exercised.[125]

Petitioners assert that the power to impose a receivership "is and has always been among the judicial powers vested in the Courts of Tennessee, and it is forbidden that any statute vest, or be construed as vesting any part of such judicial power in any member of the Legislative or Executive Departments of the State of Tennessee . . .."[126] As such, Petitioners assert that the Commissioner's appointment of a receiver is in violation of the doctrine of separation of powers and is, therefore, void.

Contrary to Petitioners' assertions, the power to institute a receivership is not the sole province of the courts. The power to institute a *court-created equity receivership* is one of the judicial powers vested in the courts. However, the power to institute an *administrative receivership* is clearly one that is vested in the executive branch of government. Indeed, the

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[124]*Bank of Commerce and Trust Company v. Senter,* 149 Tenn. 569, 260 S.W. 144, 151 (1924); *Richardson v. Young*, 122 Tenn. 471, 493, 125 S.W. 664 (1910).

[125]122 Tenn. at 493-496, 125 S.W. 664.

[126]Petition at ¶ 10(c).

courts have recognized and upheld the distinction between an administrative receivership and a court-created equity receivership.[127]

Here, the Commissioner's appointment of a receiver is part of a statutory scheme enacted by the General Assembly for the orderly liquidation of insolvent financial institutions, including trust companies. As discussed *supra*, Tenn. Code Ann. § 45-2-1502(a) authorizes the Commissioner to take possession of a trust company if he finds that certain circumstances exist. Subsection (b)(2) provides that "[w]hen the commissioner has taken possession of a state bank, the commissioner shall be vested with the full and exclusive power of management and control, including the power . . . to appoint a receiver to have all of the rights, powers, duties and obligations granted to the commissioner in possession for the purpose of liquidation or reorganization, and to reorganize or liquidate the bank in accordance with §§ 45-2-1503 and 45-2-1504...."[128] Thus, the General Assembly has given the Commissioner the specific authority to appoint a receiver after taking possession of a trust company, and such appointment pursuant to this statutory scheme clearly creates an executive or administrative receivership, as distinguished from a court created equity receivership.[129] Moreover, the United States Supreme Court has held

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[127]*See People ex rel. Knight v. O'Brien*, 240 N.E.2d 686 (Ill. 1968)(citing *In re Casualty Co. of America*, 155 N.E. 735 (NY 1927); *Riches v. Hadlock*, 15 P.2d 283, 288 (Utah 1932); *People ex rel. Barrett v. Shurtleff*, 187 N.E. 271 (1933); *People ex rel. Palmer v. Peoria Life Ins. Co.*, 192 N.E. 420 (1938)). *See also Hulman v. Lawn Savings and Loan Association*, 259 N.E.2d 324 (Ill. App. 1970) (copies attached).

[128]Tenn. Code Ann. § 45-2-802(a) and (b) provides that the Federal Deposit Insurance Corporation (FDIC) may be appoined receiver of any state bank the Commissioner has taken possession of, whose deposits are to any extent insured by the FDIC and specifically gives the Commissioner, after taking possession of such state bank, the "right to appoint the Federal Deposit Insurance Corporation as receiver."

[129]*See People ex rel. Palmer v. Niehaus*, 190 N.E. 349 (1934). In that case the court held that receiverships established pursuant to the Illinois Insurance Liquidation Act of 1933 and the Illinois Banking Act were executive or administrative receiverships. The court further emphasized that "by the Insurance Liquidation Act and the Banking Act the legislature sought to 'avoid difficulties and complications attending the appointment of receivers by courts,' and that the statute 'makes the receiver an executive or administrative officer and not a judicial officer.'

that the administrative taking over of a financial institutions, *i.e.*, the appointment of a receiver, is constitutionally unobjectionable.[130]

Accordingly, the Commissioner's appointment of a receiver here does not violate the doctrine of separation of powers and such claims should be dismissed in their entirety.

C. There Is Substantial And/Or Material Evidence In The Record To Support The Commissioner's Decision To Take Possession Of SentinelAnd Subsequent Decision To Liquidate.

As discussed *supra*, this Court's scope of review under the common law writ of certiorari is limited to the record and covers only an inquiry into whether the Commissioner exceeded his jurisdiction, followed an unlawful procedure, acted illegally, fraudulently, or arbitrarily or acted without material evidence to support his decision to take possession of Sentinel and subsequent decision to liquidate the company. Petitioners make a number of allegations and arguments in their petition which they assert support the need for a writ of supersedeas.[131] These allegations and arguments fall into two main categories: (1) allegations with respect to the amount of the cash deficiency in the pooled fiduciary account and Sentinel's ability to make that account whole over time[132] and (2) allegations attacking actions taken by the Commissioner within the context of the receivership.[133]

(Copy attached).

[130]*Fahey v. Mallonee*, 332 U.S. 245, 67 S.Ct. 1552, 91 L.Ed. 2030 (1947).

[131]Petition at ¶¶ 14-30.

[132]*Id.* at ¶¶ 14-19.

[133]*Id.* at ¶¶ 20-30.

With respect to Petitioners' allegations attacking the Commissioner's actions within the context of the receivership (*e.g.* freezing funds in the pooled fiduciary account[134]; delaying pursuit of collection activities[135]; seeking court approval to pay bondholders[136]; and, performing the functions of Sentinel as Trustee, Bond Registrar or Paying Agent[137]) the Commissioner respectfully submits that these issues are not within the scope of this Court's review, as set forth above, under the common law writ of certiorari. Rather, these issues are entirely within the jurisdiction and review of the Lewis County Chancery Court, in which the *in rem* receivership proceeding is pending. Accordingly, this Court should not consider these issues in reviewing whether the Commissioner exceeded his jurisdiction or acted illegally, arbitrarily or capriciously in taking possession and liquidating Sentinel.

As for Petitioners' allegations concerning the amount of the cash deficiency in the pooled fiduciary account and Sentinel's ability to replenish that amount over time, while confusing and contradictory, these allegations should be construed as an assertion that there is not substantial or material evidence in the record to support the Commissioner's decision to take possession and subsequently to liquidate Sentinel.

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[134] *Id.* at ¶ 20.

[135] *Id.* at ¶ 21..

[136] *Id.* at ¶ 24.

[137] *Id.* at ¶ 25.

1. Material Evidence In The Record Supporting Decision To Take Possession

Tenn. Code Ann. § 45-2-1502(a) provides that the Commissioner may take possession of a state bank or a trust company if he finds:

> (1) Its capital is impaired or it is otherwise in an unsound condition;
> (2) Its business is being conducted in an unlawful or unsound manner;
> (3) It is unable to continue normal operations; or
> (4) Its examination has been obstructed or impeded.

The Commissioner is only required to find that one of these conditions exists in order to take possession of a trust company. Thus, under the standard of review for the common law writ, if there is substantial or material evidence in the record to support a finding of any of these conditions, then the Commissioner's decision to take possession of Sentinel must be upheld.

The Commissioner took possession of Sentinel based upon the existence of two of these conditions: (1) that Sentinel's business was being conducted in an unsound manner and (2) Sentinel was unable to continue normal operations.[138] Specifically, the Commissioner found that Sentinel had used pooled fiduciary funds to provide operating capital for non-related defaulted bond issues, thereby creating a fiduciary cash shortfall that greatly exceeded Sentinel's current operating capital and that Sentinel had failed to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion and to keep accurate books and records.[139] The Commissioner further found that Sentinel's potential liability for the cash shortfall in the pooled

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[138] *See* Notice of Possession, R. Vol. III, 464-466..

[139] *Id.*

fiduciary account exceeded its current capital level and that Sentinel has been unable to provide a viable capital plan that would eliminate the deficiency and make the account whole.[140]

Petitioners do not deny either of these findings. Indeed, Petitioners admit in their petition that: (1) the "customary mode of conducting [their] business has long been that all funds [Sentinel] receives as fiduciary under different bond issues are deposited in its correspondent F.D.I.C.-insured Bank account to be held in its name as a fiduciary, ..."[141]; (2) that "[m]oneys from what Respondent Commissioner has labeled the "pooled bond funds" were used in carrying out Sentinel's liquidation obligations, including the payment of attorneys fees, other litigation expenses, and in some cases, moneys required to be paid by orders of courts in some of the many litigations occurring as a result of the defaults"[142]; and, (3) that this practice of borrowing from non-related bond issues monies on deposit in the pooled fiduciary account to fund the expenses of defaulted bond issues instead of using corporate assets, where the defaulted issues themselves did not have sufficient funds on deposit with Sentinel resulted in "a deficiency in cash in some unknown amount" in the pooled fiduciary account.[143]

Thus, Petitioners admit to engaging in a practice, which is clearly in violation of Tenn. Code Ann. § 45-2-1003(1); the FDIC's Statement of Principles of Trust Department Management, adopted as part of Sentinel's corporate policies; and, the trust indentures or other contractual agreements between the bond issuers and Sentinel as fiduciary. Such a practice

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[140] *Id.*

[141] Petition at ¶ 13.

[142] Petition at ¶ 14.

[143] *Id.* at ¶ 18.

clearly constitutes the conduct of business in an unsound manner and accordingly, there is material evidence in the record to support the Commissioner's decision to take possession of Sentinel.

2. Material Evidence In The Record Supporting Decision To Liquidate.

As discussed in Section I, on June 15, 2004, the Commissioner received a preliminary report from the Receiver and his staff which indicated that Sentinel had a fiduciary cash deficiency ranging from between $7.6 and $8.4 million (not including the additional $301,234.11 in outstanding bond principal and interest checks owed to bondholders).[144] The report further indicated that Sentinel was operating at a net loss and was insolvent at least in the amount of $6.225 million.[145] Based upon this information, the fact that management had no viable plan for the infusion of capital, and the record as a whole, the Commissioner determined that liquidation of the company was necessary and appropriate.[146]

Title 45 does not provide any statutory standards or guidelines for determining when a bank or trust company in possession should be liquidated. Rather, it leaves the decision to the discretion of the Commissioner.[147] Although, Petitioners admit they borrowed from non-related bond issues to fund the expenses of defaulted bond issues instead of using corporate assets, and that "a deficiency in cash in some unknown amount" exists, they argue that the Commissioner should not have decided to liquidate Sentinel because: (1) the amount of this deficiency is an

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[144]R. Vol. III, 623-643.

[145]*Id.*

[146]R. Vol. III, 644-646.

[147]*See* Tenn. Code Ann. § 45-2-1502(b)(2) and (c)(2).

"inflated" amount due to the accrual of Sentinel's administrative fees and, therefore, does not represent an actual cash deficiency in that account; and (2) since the funds in the pooled fiduciary account are not "due on demand", there would be no immediate risk in allowing Petitioners to "work out" the deficiency over time through the Sentinel's administrative fees and expected recoveries on the defaults.[148]

The evidence in the record simply does not support either of these assertions. With respect to the "true amount" of the deficiency, Petitioners first allege that in carrying out their "security-enforcement obligations to bondholders", they kept meticulous records with respect to all cash held, receipts and expenditures for each bond issue.[149] This assertion is contradicted by Petitioners' subsequent admission that "there is a deficiency in cash in some unknown amount."[150] More importantly, this assertion is directly contrary to the company's records.

Sentinel currently uses two different accounting systems — AccuTrust and Quickbooks. AccuTrust is a single entry system, *i.e.*, it only allows for the entry of an item as either income or expense. Quickbooks is a dual entry system, *i.e.*, for each debit recorded there is a corresponding credit and vice versa). It is also an "active" accounting system, in that it allowed President Bates to pay monies out of the corporate and trust accounts. President Bates has consistently represented to the Department, however, that AccuTrust is the company's official fiduciary accounting record. Records beginning with December 31, 1999 are reflected on both systems.

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[148]Petition at ¶¶ 15-19.

[149]Petition at ¶ 15.

[150]Petition at ¶ 18.

Before these two systems, Sentinel had utilized TrustNet, a DOS based system, for its fiduciary accounting, and AccuGen, a Linux based system, for its general ledger accounting. [151]

In its very first examination of Sentinel for the period ending December 31, 1999, the Department determined that President Bates was responsible for all trust company activities, including managing and monitoring existing accounts, compilation of the general ledger, asset management and account reconciliation.[152] In its second examination for the period ending December 31, 2000, the Department found that President Bates was still reconciling deposit accounts with no documented review by another party[153] and that there were inconsistencies in the accuracy of the corporate and trust records, such that "[r]econciling trust and corporate general records was difficult" and that "[t]he accuracy of reports appears suspect due to inconsistencies in totals, as well as, the varying formats and data processing systems used."[154] Thus, since the inception of management's use of the AccuTrust and Quickbooks systems, documented inconsistencies have existed between these two systems.

These inconsistencies grew so pronounced that in July, 2003, Sentinel's audit firm, Charles Welch and Associates, CPA, resigned and President Bates was forced to hire an independent CPA just to reconcile the cash accounts, including the pooled fiduciary account.[155] In reconciling the pooled fiduciary account as of December 31, 2003, the independent CPA

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[151] *Id.*

[152] R. Vol. I, 20, 23-24.

[153] R. Vol. 1, 62.

[154] R. Vol. 1, 71.

[155] R. Vol. I, 195-196.

determined that the cash balance of that account was $10,897,183.[156] The AccuTrust system, however, showed a cash balance of $14,197,093 and Quickbooks showed a cash balance of $14,197,095 as of that same date.[157] Additionally, at the time the Comissioner took possession of Sentinel on May 18, 2004, AccuTrust showed a cash balance in the fiduciary account of ***$10,280,912,*** while QuickBooks showed a balance of ***$10,386,921***. The bank statement from SunTrust, however, reflected a cash balance in the fiduciary account of only ***$2,472,928***.[158] ***Based solely upon these amounts as reflected in Sentinel's records and the bank statement, there was a cash deficiency in the pooled fiduciary account of over $7.8 million.***

Again, although admitting that they do not know the actual amount of the cash deficiency in the fiduciary account, Petitioners next assert that the amount identified by the Commissioner (based upon Sentinel's own records, the SunTrust bank statement and the reconciliation done by Sentinel's own independent CPA) is "inflated" because it includes Sentinel's accrued default and administration fees and, therefore, the true amount of the deficiency (*i.e.*, actual cost or monies spent in carrying out fiduciary obligations) is only a "small fraction" of the $7.6 - $8.4 million deficiency.[159] Again, the evidence in the record, and Sentinel's own records do not support this contention.

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[156]*See* Affidavit of Wade McCullough, Exhibit 1.

[157]*Id.*

[158]By the time the preliminary report was issued to the Commissioner on June 15, 2004, the balance in both the SunTrust and Union Planters fiduciary accounts (which had a balance of $41,601.00) had decreased to a total of $2,410,063 as a result of checks written prior to May 18, 2004 being cleared. (There is no local branch of SunTrust in Hohenwald. Because of this, Sentinel had been using its corporate account at Union Planters to receive funds from bond issuers and then transferring them to the pooled fiduciary account at SunTrust. At the direction of their auditors, Sentinel set up a fiduciary account at Union Planters to now receive these funds.) *Id.*

[159]Petition at ¶ 17.

First, in proposing the steps management would take to maximize the funds available to repay any deficits in defaulted trust accounts, legal counsel represented to the Commissioner in May, 2004 that "[b]ased upon our investigation to date, ***it appears that most of these expenses were for the payment of legal fees*** incurred in pursuing claims against issuers and other parties involved in the defaulted bond issues."[160]

Second, an analysis of Sentinel's records reflects that Sentinel has listed over $1 million in accounts receivable[161] from a number of previously defaulted bond issues for which there is no documentary support.[162] Each and every one of these accounts, however, reflects a positive cash balance in the pooled fiduciary account. In fact, Sentinel's own records reflect that these bond issues should have had ***$2,015,388.83*** on deposit in the pooled fiduciary account as of May 18, 2004. As discussed *supra*, that account had only ***$2,410,063*** as of that date.[163] Moreover, further analysis of Sentinel's records reveals that these expenses and fees have already been paid and that these bond issues currently owe no funds to Sentinel.[164]

Third, the Department has identified a number of bond issues allegedly owing fees, which management capitalized and recognized at a time when none of these issues had a positive cash balance in the pooled fiduciary account and when the Department was investigating

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[160]R. Vol. III, 448 (emphasis added).

[161]As discussed in the Petition, when expenditures on a defaulted bond issues exceed the amount of cash on deposit with respect to that issue, Petitioners' classified the excessive payments as an "overdraft" in AccuTrust. Petition at ¶ 15. However, on May 11, 2004, Petitioners transferred these overdrafts in AccuTrust to the Accounts Receivable Account in QuickBooks, thus excluding these overdrafts from the AccuTrust account records. *See* Affidavit of Wade McCullough, Exhibit 1.

[162]*See* Affidavit of Wade McCullough, Exhibit 1.

[163]*Id.*

[164]*Id.*

management's practice of borrowing from the pooled fiduciary account to fund expenses of the defaulted bond issues.[165] Specifically, on April 15 and 16, 2004, management recognized default fees that had been assessed against a number of bond issues for January and February, 2004. Management then transferred a total of $82,973.98 from the pooled fiduciary account at SunTrust to the corporate account at Union Planters.[166]

Thus, Sentinel's own records contradict Petitioners' assertion that the deficiency in the pooled fiduciary account is inflated. Additionally, none of Petitioners' arguments provides an explanation for the simple fact that its own records (AccuTrust) reflect that the fiduciary account had a cash balance of ***$10,280,912***, while the bank statement from SunTrust showed a cash balance in the fiduciary account of only ***$2,410,063*** as of May 18, 2004. Given that Sentinel has a net worth of only $1.3 million, this cash deficiency is, standing alone, sufficient evidence for the Commissioner to determine that liquidation was necessary and appropriate.

However, Petitioners make the additional argument that the company's fee receipts and entitlements are available to cover this deficiency and that instead of liquidation, the "sensible remedy" is to

> continue vigorously pursuing collection efforts to liquidate assets subject to the bond liens held for the protection of bondholders, and as well for Sentinel, which has priority over the bondholders for fiduciary expenses and fees, and then if there remains a deficiency in cash, for Sentinel to then pay that deficiency to the extent of its liability therefor.[167]

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[165]*See* Affidavit of Wade McCullough, Exhibit 1.

[166]*Id.*

[167]Petition at ¶ 18.

In other words, Petitioners assert that instead of liquidating the company, the Commissioner should have rehabilitated the company, by allowing management to "work-out" the cash deficiency in the pooled fiduciary account through current fees and future trust revenues and through the collections on the defaulted bond issues.

As noted previously, the decision whether to rehabilitate or liquidate a bank or trust company in possession is left to the discretion of the Commissioner.[168] However, Tenn. Code Ann. § 45-2-1503(a) does provide that a plan of reorganization ***shall not*** be prescribed unless:

> (1) The plan is feasible and fair to all classes of depositors, creditors and stockholders;
> (2) The fact amount of the interest accorded to any class of depositors, creditors or stockholders under the plan does not exceed the value of the assets upon liquidation, less the full amount of the claims of all prior classes, subject, however, to any fair adjustment for new capital that any class will pay in under the plan;
> (3) The plan provides for the issuance of common stock in an amount that will provide an adequate ratio to deposit;
> (4) Any exchange of new common stock for obligations of stock of the bank will be effected in inverse order to the priorities in liquidation of the classes that will retain an interest in the bank and upon terms that fairly adjust any change in the relative interest of the respect classes that will be produced by the exchange;
> (5) The plan assures the removal of any director, officer or employee responsible for any unsound or unlawful action or the existence of an unsound condition; and
> (6) Any merger or consolidation providedby the plan conforms to the requirements of this chapter and chapter 1 of this title.

Petitioners' "plan" for rehabilitating or reorganizing Sentinel clearly does not meet any of these requirements. In particular, the plan does not provide for the "removal of any director, officer or employee responsible for any unsound or unlawful action or the existence of an unsound

[168]Tenn. Code Ann. § 45-2-1502(b)(2) and (c)(2).

condition." As such, the Commissioner is prohibited by statute from authorizing Petitioners' plan.

Furthermore, the evidence in the record reflects that Petitioners' plan for "working-out" the deficiency is simply not feasible. First, Sentinel's ***total net income for the past eight years is only $1,370,149.04***.[169] Moreover, this amount includes the $575,000 settlement paid in 2000 as a result of management having been found in violation of its fiduciary duties, which the company was required to recognize as a one-time charge to its income statement. Without credit for this amount, ***Sentinel's total net income since 1996 would only be $795,149.04***.

Additionally Sentinel's current fee revenues are not sufficient to cover the operating expenses of the company. For the first four months of 2004, the company had a ***net loss of $163,501.16***.[170] By the time the Commissioner took possession on May 18, 2004, that ***net loss had increased to $197,917***.[171] Moreover, even if management had been successful in obtaining

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[169] *See* Affidavit of Wade McCullough, Exhibit 1.

[170] R. Vol. III, 588.

[171] R. Vol. III, 634. Included in this net loss position is the recognition of losses totaling $100,522 in relation to two defaulted bond issues: Sullivan County, TN and Jose Eber Salons, Inc. Management had previously used funds out of the pooled fiduciary account to fund expenses of both these defaulted issues and recorded those monies as overdrafts on these accounts. Management had now finally determined in April, 2004, that there would be no recovery on these two defaulted issues and, therefore, recognized the loss on its income statement. However, the recognition of the loss on the Jose Eber Salons issue was not recorded by management in the accounting of overdraft-receivable balances. Additionally, management only recognized a loss of $25,136 on the Jose Eber Salon issue, while its accounting records indicated that the overdraft-receivable balance was actually $133,701.96. *See* R. Vol. III, 628. As such, management should have recognized an additional loss of $108,565.96 on its income statement, thus increasing the company's net loss to $306,482.96 as of May 18, 2004. *See* Affidavit of Wade McCullough, Exhibit 1.

the three new bonds issues referenced in the Affidavit of Bradley Lancaster, it would only have resulted a maximum of $43,250 in additional income for 2004.[172]

Furthermore, in the examination report for the period ending December 31, 2001, the Department noted that "[e]arnings are less than satisfactory and are not commensurate with the risk associated with the fiduciary activities undertaken. Risk exposure is noted in relation to the default issues and corresponding pending litigation which could threaten the company's capital base."[173] The report further noted that no reserves were maintained by management in relation to this risk.[174] Finally, the report noted that the company had no formal written strategic business plan, although the "directorate has periodic discussions of prospective business opportunities."[175]

In light of the company's past earnings performance; the lack of any reserve in relation to losses from defaulted issues; the lack of a strategic business plan; and, the fact that current revenues are insufficient to cover expenses and the company is operating at a net loss, Petitioners' plan to use current and future trust revenues to "work out" a deficiency well in excess of $8 million dollars is simply unrealistic.

Finally, in what appears to be a desperate attempt to identify additional monies owed to Sentinel that would be available to fund the deficiency, Petitioners assert that the company is

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[172]Mr. Lancaster's affidavit asserts that Sentinel would have received a total of $40,250 in financial advisory fees and $52,000 in registering fees over the duration period of the bond (10-32 years). Only the financial advisory fee would be paid immediately to Sentinel. The registering fee would be paid either on an annual or semi-annual basis, such that the company would have received at most $3000 in registering fees from these three bond issues.

[173]R. Vol. I, 134.

[174]*Id.* at 133.

[175]*Id.*

entitled to over $6 million in uncashed checks and unposted fees from the pooled funds. With respect to the uncashed checks, Petitioners allege that Sentinel earned fees under its contracts with the non-defaulted bond issues and

> when the excessive withdrawals became necessary, while periodic checks were issued to Sentinel, it retained some of them uncashed so that for each such uncashed check, the cash remained in the "pooled trust fund" as security against inadequate liquidity." On the date the Respondent Commissioner seized possession of Sentinel properties, the total of such uncashed checks held by Sentinel, to assure adequate liquidity, was approximately $2,600,000.00.[176]

There are several problems with this allegation. First, the Receiver and Department Staff have conducted a reasonable search of Sentinel's offices and records and have found no evidence of any uncashed checks made payable to Sentinel.[177] Second, assuming that these checks do in fact exist, they would increase the amount of the cash deficiency in the pooled fiduciary account. Petitioners state in their petition that it is their customary mode of conducting business to deposit ***all funds*** it receives as a fiduciary under different bond issues into its correspondent F.D.I.C.-insured bank account - the pooled fiduciary account at SunTrust bank.[178] Thus, when Sentinel received the alleged $2.6 million in fees from the non-defaulted bond issues, these funds would have been deposited into the pooled fiduciary account and the checks to Sentinel would have been written out of that same account, in accordance with Petitioners' customary mode of conducting business.

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[176]Petitioner at ¶ 18.

[177]*See* Affidavit of Wade McCullough, Exhibit 1.

[178]Petition at ¶ 13.

Petitioners allege that they did not cash these checks in order to assure adequate liquidity in the pooled fiduciary account. However it is undisputed that at the time the Commissioner took possession of Sentinel, the SunTrust bank statement showed that the cash balance in that account was only ***$2,410,063***, less than even the $2.6 million Petitioners allege was owed to Sentinel. [179] Accordingly, if in fact there exists $2.6 million in uncashed checks written on the pooled fiduciary account, the cash deficiency in that account would actually be increased to well in excess of $11 million dollars.

With respect to the unposted fees, Petitioners allege that

> since the commencement of the problems caused by the defaults on 63 bond issues, . . . Sentinel has withheld posting additional fees it is entitled to post and pay itself, and the unposted fee entitlement totals an estimated amount of about $3,500,000.00.[180]

Again, there are numerous problems with this allegation. First, while claiming that it is entitled to an additional $3.5 million in fees from the 63 defaulted bond issues, Petitioners themselves admit that 50 of the 63 defaulted issues were closed as of December 31, 2003 — thus leaving only 13 bond issues from which this alleged $3.5 million could be collected.[181] Second, assuming that the company is entitled to this additional $3.5 million in fees that management chose not to post, such allegation directly contradicts Petitioners assertion that "Sentinel meticulously assigned all cash held, receipts and expenditures to the bonded debtor to which they were related".[182]

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[179] *See* fn. 158, *supra*.

[180] Petition at ¶ 18.

[181] *See* Petition at ¶ 14.

[182] *Id.* at ¶ 15.

This allegation is also contrary to President Bates' express representations to the Commissioner. In response to the Commissioner's specific request that management "provide information as to how overdrafts are currently being funded for various bond issues,"[183] President Bates sent a letter to the Commissioner dated April 16, 2003. In that letter, President Bates stated "***[f]ees and expenses are charged to the appropriate principal or income cash account of trust accounts as and when the fees and expenses are incurred.***"[184]

Third, this allegation of earned but unposted $3.5 million in fees also directly contradicts Petitioners' assertion that the cash deficiency in the fiduciary account is "inflated" because it includes Sentinel's accrued default and administration fees.[185] Specifically, Petitioners allege that a charge of 1.5% was added to the "overdraft" balance on each overspent fund each month, in addition to a one-time default fee of $25,000, and, therefore, "the cumulative "overdraft" balance is far greater than the money utilized from the pooled fund to carry out Petitioners' fiduciary responsibilities."[186]

Thus, if Petitioners's allegation is true that the deficiency is inflated as a result of the cumulative fees and charges on the overdraft balances, then the allegation of $3.5 million in unposted fees is erroneous. Conversely, if Petitioners's allegationthat they did not post this $3.5 million in fees is correct, then the deficiency in the pooled fiduciary account is not "inflated", but is the actual cash deficiency in that account. Regardless of which allegation is correct, neither

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[183]*See* fn. 28, *supra.*

[184]*See* fn. 29, *supra.*

[185]Petition at ¶ 17.

[186]Petition at ¶ 17.

provides an explanation for the simple fact that Sentinel's own records (AccuTrust) reflect that the fiduciary account had a cash balance of ***$10,280,912***, while the bank statement from SunTrust showed a cash balance in the fiduciary account of only ***$2,410,063*** when the Commissioner took possession on May 18, 200 — thus reflecting a *cash* deficiency of approximately $7.8 million for which Sentinel is ultimately liable.

IV. CONCLUSION

Tenn. Code Ann. § 45-1-124 makes it unmistakably clear the General Assembly's intent that ***all*** of Chapters 1 and 2 of Title 45 ***shall*** apply to the operation and regulation of state trust companies, and that such companies shall fully comply and conform with all the provisions of these chapters, and not just the provisions pertaining to fiduciary activities. Accordingly, the Commissioner did not exceed his statutory authority or act illegally in taking possession of Sentinel Trust Company. Additionally, there is both substantial and material evidence in the record to support the Commissioner's decisions to take possession and to liquidate the company.

For these reasons, the Commissioner respectfully requests that this Court dismiss the Petition for Writs of Certiorari and Supersedeas in their entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Response has been sent by first class U.S. Mail, postage prepaid, to: Carroll D. Kilgore, Branstetter, Kilgore, Stranch & Jennings, 227 Second Avenue North, Fourth Floor, Nashville, TN 37201-1631, this 27th day of July, 2004.

Janet M. Kleinfelter

JANET M. KLEINFELTER
Senior Counsel